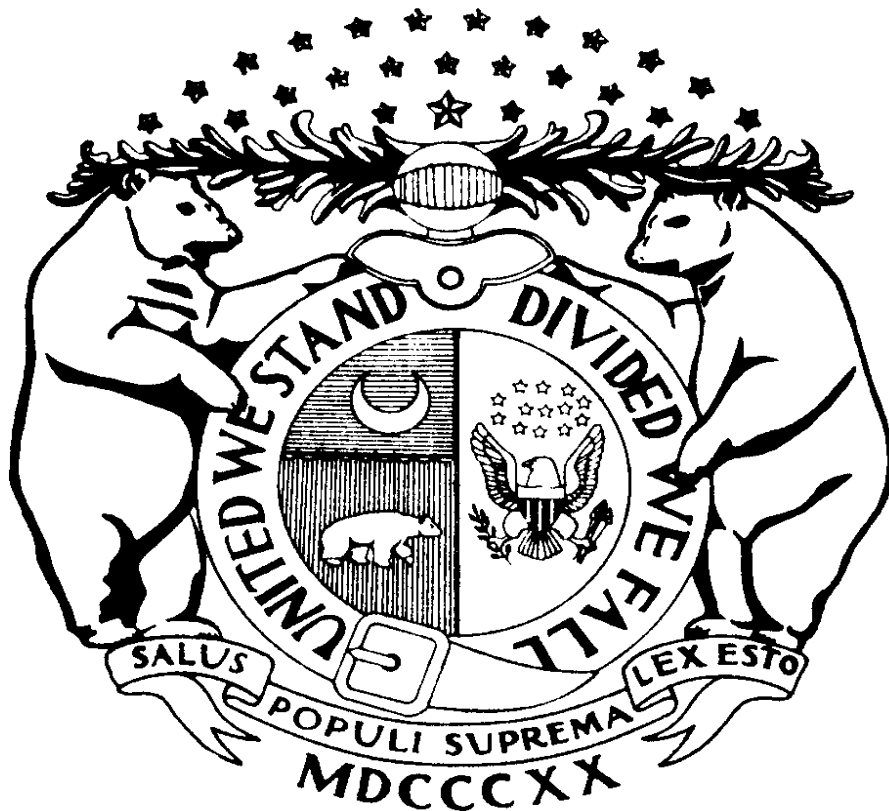


REPORT OF
ASSOCIATION FINANCIAL EXAMINATION

**AMERICAN LIFE AND HEALTH
INSURANCE COMPANY**

AS OF
DECEMBER 31, 2001



STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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Mission Viejo, CA
June 13, 2003

Chairman of Financial Condition (EX4) Subcommittee
Southeastern Zone Secretary
Alfred W. Gross, Commissioner
Virginia Bureau of Insurance

Midwestern Zone Secretary
Sally McCarty, Commissioner
Indiana Department of Insurance

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, 6 North
Jefferson City, Missouri 65102-0690

Ladies and Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

American Life and Health Insurance Company

hereinafter referred to as such, as the "Company" or as "American L&H". Its administrative office is located at 27725 Santa Margarita Parkway, Suite 220, Mission Viejo, California 92691, telephone number (949) 380-0233. This examination began on January 6, 2003, and concluded on the above date.

SCOPE OF EXAMINATION

Period Covered

The prior full scope association financial examination of American Life and Health Insurance Company was made as of December 31, 1998, and was conducted by examiners from the State of Missouri representing the Midwestern Zone of the National Association of Insurance Commissioners (NAIC).

The current full scope association financial examination covers the period from January 1, 1999, through December 31, 2001, and was conducted by examiners from the State of Missouri, representing the Midwestern Zone of the NAIC, with no other zones participating. A financial examination of Cambridge Life Insurance Company (Cambridge Life), the wholly owned subsidiary (as of December 31, 2001) of American L&H, was conducted by the Missouri Department of Insurance (MDI) concurrently with this examination.

This examination also included the material transactions and/or events occurring subsequent to the examination date which are noted in this report.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the NAIC, except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the State of Missouri prevailed.

The examiners relied upon information supplied by the Company's independent auditors, Deloitte & Touche LLP of Costa Mesa, California, from its audit covering the

period from January 1, 2001, through December 31, 2001. This information included, but was not limited to, attorneys' letters, bank account confirmations, and internal control evaluations.

Comments-Previous Examination

Listed below are the comments, recommendations, and notes of the previous examination report, dated as of December 31, 1998, and the subsequent response or action taken by the Company.

Corporate Records

Comment: Although general approval of any and all legal actions during the year was noted in the minutes of actions, there was no evidence that major contracts and transactions were reviewed. It was recommended the minutes or actions specifically include the review and approval of major contracts and transactions during the year.

Company's Response: A report of material contracts and transactions will be prepared prior to all meetings of the board of directors. The report will be reviewed and the approval of the transactions will be included in the minutes of the meeting.

Current Findings: It appears the Company appropriately noted the review and approval of major contracts and transactions in the minutes during the current examination period.

Intercompany Transactions

Comment: The fee being charged for data processing under the agreement with CHP Administration, Inc. was not consistent with the January 1998 amendment. The Company indicated that it expected to terminate this contract in 1999. The Company was directed to either comply with the contract terms, amend the contract to be consistent with current practice, or terminate the contract.

Company's Response: The fees charged during 1999 under this agreement have not been amended since the original contract was signed. American L&H gave notice to CHP Administration, Inc. that this contract would terminate effective December 31, 1999.

Current Findings: It appears the data processing agreement was terminated effective December 31, 1999 with no fees paid subsequently.

Comment: The Company was directed to pay interest to Cambridge Life for the 1997 loans, such interest to be at a fair and reasonable rate. The Company was also directed to file an amended Form B to disclose the 1997 loans. The Company was further directed to document any future intercompany loans or advances with a written loan agreement that requires the payment of interest at a fair and reasonable rate. Also, the Company should take the necessary steps to ensure that it appropriately discloses any future intercompany loans and provide prior notice on any loans exceeding the threshold of RSMo 382.195 (Transactions within a holding company system).

Company's Response: American L&H paid Cambridge Life interest on the 1997 loans. The rate used for this calculation was equal to the one-year treasury rate plus 1%. The Company drafted an agreement for Short-Term Loan of Expenses. No intercompany loans will be made prior to the approval of this agreement. An amended Form B will be filed with the Department within the next 60 days.

Current Findings: No evidence of any loans since 1997 was noted.

Fidelity Bond and Other Insurance

Comment: It appeared that American L&H did not have fidelity bond coverage. The Company should obtain a minimum of \$200,000 fidelity coverage as recommended by the NAIC guidelines for protection of its assets and its parent's investment in the Company.

Company's Response: American L&H does have fidelity bond coverage for the period under examination.

Current Findings: The Company did obtain coverage along with several affiliates. However, the coverage does not meet the NAIC suggested minimum in 2001 or 2002. It is recommended that the Company increase its coverage to at least the minimum suggested by the NAIC guidelines.

Insurance Products and Related Practices

Comment: The Company was directed to prepare a three to five year business plan with financial projections and submit a copy to the Missouri Department of Insurance.

Company's Response: American L&H prepared and submitted a business plan with financial projections to the Missouri Department of Insurance.

Current Findings: Adequate information was provided in this area. First Health Group Corporation, the parent of American L&H, plans to sell American L&H in the near future.

Comment: The Company was directed to review and strengthen its procedures to ensure that, in the future, any administrator which should be classified as a managing general agent is identified in a timely manner through a quarterly review. The Company was further directed to ensure that it complies, on a timely basis, with all reporting and other provisions of 20 CSR 200-10 (Managing General Agents).

Company's Response: The company has implemented a quarterly review process to ensure that any administrator which should be classified as a managing general agent is identified. American L&H will comply with all reporting and other provisions of 20 CSR 200-10 (Managing General Agents).

Current Findings: The Company did not have any agents that qualified as Managing General Agents as of December 31, 2001.

Comment: The Company was directed to perform, on a regular basis, periodic on-site premium and claims reviews of administrators with significant premium or claims volume.

Company's Response: American L&H has implemented procedures to perform quarterly audits of administrators with significant premium or claims volume.

Current Findings: The Company has established procedures to perform annual audits of administrators with significant premium or claims volume. Based on the current number of administrators and their volume, this appears to be adequate.

Reinsurance Ceded

Comment: The Company's Excess of Loss Agreement with AIG Life Insurance Company (AIG) did not contain an insolvency clause. The Company was directed to amend the agreement to include an insolvency clause which meets the approved wording as stated in Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance).

Company's Response: American L&H has asked AIG Life Insurance Company to amend their agreement to include an insolvency clause which meets the approved wording in Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance).

Current Findings: During the examination period, the Company obtained post-contract amendments adding the insolvency clause. This is unacceptable and does not meet the requirements of Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance). The Company is directed to ensure that reinsurance credits are not taken for any reinsurance agreement that does not fully comply with all the provisions of Missouri Regulation 20 CSR 200-2 (Credit for Reinsurance).

Comment: Effective September 1, 1995, the Company entered into a quota share arrangement whereby it cedes 90% of the PADI life business to Hanover Lloyds. The Company had a Cover Note highlighting various provisions, but the Company did not have a signed agreement covering the arrangement. American L&H was directed to obtain a written agreement for this, and all, reinsurance contracts. The Company was further directed to non-admit any asset or credit related to reinsurance agreements not documented by a signed written contract.

Company's Response: As of January 1, 1999, American L&H has not admitted any asset or credit related to the reinsurance agreement with Hanover Lloyds.

Current Findings: The Company provided signed contracts for all active reinsurance agreements as of December 31, 2001.

HISTORY

General

American L&H was incorporated under the stipulated premium laws in the state of Missouri on July 2, 1925, and was licensed and commenced business on November 2, 1925. On October 21, 1968, the Company was converted to a legal reserve life insurance company under the provisions of Missouri statutes 376.010 to 376.670.

On December 25, 1985, an Agreement and Plan of Merger was approved by the Director of the Missouri Department of Insurance whereby Creative Health Programs Administration, Inc. (CHP), a California corporation, became the parent of the Company. Ultimate control was held by the von Grep family, which effectively owned 100% of CHP.

On April 30, 1987, the Company's name was changed from American Life and Accident Insurance Company of St. Louis to its current name, American Life and Health Insurance Company.

Effective January 31, 1996, First Health Group Corporation (FHGC), formerly Health Care COMPARE Corporation, a Delaware corporation, purchased 100% of the stock of CHP, effectively making FHGC the ultimate parent of American L&H.

On May 31, 2001, American L&H obtained approval from the MDI and the California Department of Insurance for the merger of CHP and American L&H. CHP was subsequently dissolved, and American L&H became a wholly owned subsidiary of FHGC.

Capital Stock

As of December 31, 2001, the Company was wholly owned by the First Health Group Corporation. The Company had 146,500 authorized shares of common stock with a par value of \$17.07. As of December 31, 2001, all 146,500 authorized shares were issued and outstanding for a total balance of \$2,500,755 in the Company's common capital stock account.

Dividends

No dividends were paid to stockholders during the examination period.

Management and Control

The directors elected and serving as of December 31, 2001, were as follows:

<u>Name and Address</u>	<u>Business Affiliation</u>
Alton Lee Dickerson Suisun, California	Executive Vice President Provider Networks First Health Group Corporation
Patrick Geary Dills Hinsdale, Illinois	Executive Vice President Sales First Health Group Corporation

Susan Flemming
Naperville, Illinois

Senior Vice President, Product Management
First Health Group Corporation

Lottie A. Kurcz
Chicago, Illinois

Vice President
American Life and Health Insurance Co.
Cambridge Life Insurance Company
Senior VP Strategic Business Development
First Health Group Corporation

Susan Oberling
Naperville, Illinois

Senior Vice President, Integrated Services
First Health Group Corporation

James C. Smith
Dallas, Texas

Chief Executive Officer
First Health Group Corporation

David R. Studenmund
Evanston, Illinois

Vice President Strategic Planning
First Health Group Corporation

Joseph E. Whitters
Glen Ellyn, Illinois

Treasurer and Vice President
American Life and Health Insurance Co.
Cambridge Life Insurance Company
Vice President Finance, Treasurer, and CFO
First Health Group Corporation

Edward L. Wristen
South Barrington, Illinois

Secretary and Vice President
American Life and Health Insurance Co.
Cambridge Life Insurance Company
President and Chief Operating Officer
First Health Group Corporation

The officers elected and serving as of December 31, 2001, were as follows:

Jane Hannabach
Lottie A. Kurcz
Edward L. Wristen
Joseph E. Whitters
Susan T. Smith
Mark Mosby
Margaret Jones

President
Vice President
Vice President and Secretary
Vice President and Treasurer
Assistant Secretary
Assistant Secretary
Assistant Secretary

As of December 31, 2001, the Company had no active committees.

Conflict of Interest

A conflict of interest statement is signed by the directors, officers and key employees each year. Signed statements were reviewed for the directors, officers and key employees during the examination period. No material conflicts were revealed.

Corporate Records

The Articles of Incorporation and Bylaws of the Company were reviewed for the examination period. The Articles were amended on October 30, 2000, to change the principal office address to: 27725 Santa Margarita Parkway, Suite 220, Mission Viejo, CA 92691. The Bylaws were not amended or restated during the examination period.

The shareholder and the board of directors do not always have formal meetings. When meetings are not held, all actions by the shareholder or the board of directors are a result of “Unanimous Written Consent of the Sole Shareholder” (in lieu of meeting) and “Unanimous Written Consent of the Board of Directors” (in lieu of meeting). The stockholder actions are signed by Edward Wristen, on behalf of FHGC, and all directors sign the actions taken by the board of directors.

Acquisitions, Mergers and Major Corporate Events

See the “General” portion of the History section of this examination report.

Surplus Debentures

Prior to May 31, 2001, the Company had two surplus notes issued and outstanding. The first surplus note, dated September 8, 1989, was issued to CHP, as the note holder, in the amount of \$300,000 and an interest rate of 8%. As of May 31, 2001,

accrued interest of \$274,389 had been added to the note held by CHP, for a total of \$574,389.

The second surplus note was dated February 15, 1996, and issued to FHGC, as the note holder, in the amount of \$5,000,000. This surplus note earned 8.25% interest and was scheduled to mature ten years from the date executed. As of May 31, 2001, accrued interest of \$2,062,370 had been added to the note held by FHGC, for a total of \$7,062,370.

On May 31, 2001, American L&H obtained approval from the MDI and the California Department of Insurance for the merger of CHP and American L&H. As a result of the merger, the board of directors of CHP and FHGC resolved to forgive the outstanding surplus notes plus any accrued interest. The CHP surplus note was eliminated during the merger of the intercompany balances. The Paid In Surplus of the Company was increased by \$7,061,370, and \$1,000, as a result of the forgiveness of the surplus notes and value of the common stock of CHP, respectively.

As of December 31, 2001, the Company did not have any surplus notes issued and outstanding.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

American Life and Health Insurance Company is a member of an Insurance Holding Company System as defined by Section 382.010 RSMo (Definitions). As of December 31, 2001, American L&H owned 100% of Cambridge Life Insurance Company (Cambridge Life), a Missouri-domiciled life and health insurance company. Cambridge Life was subsequently sold in 2002 to another affiliate, First Health Services

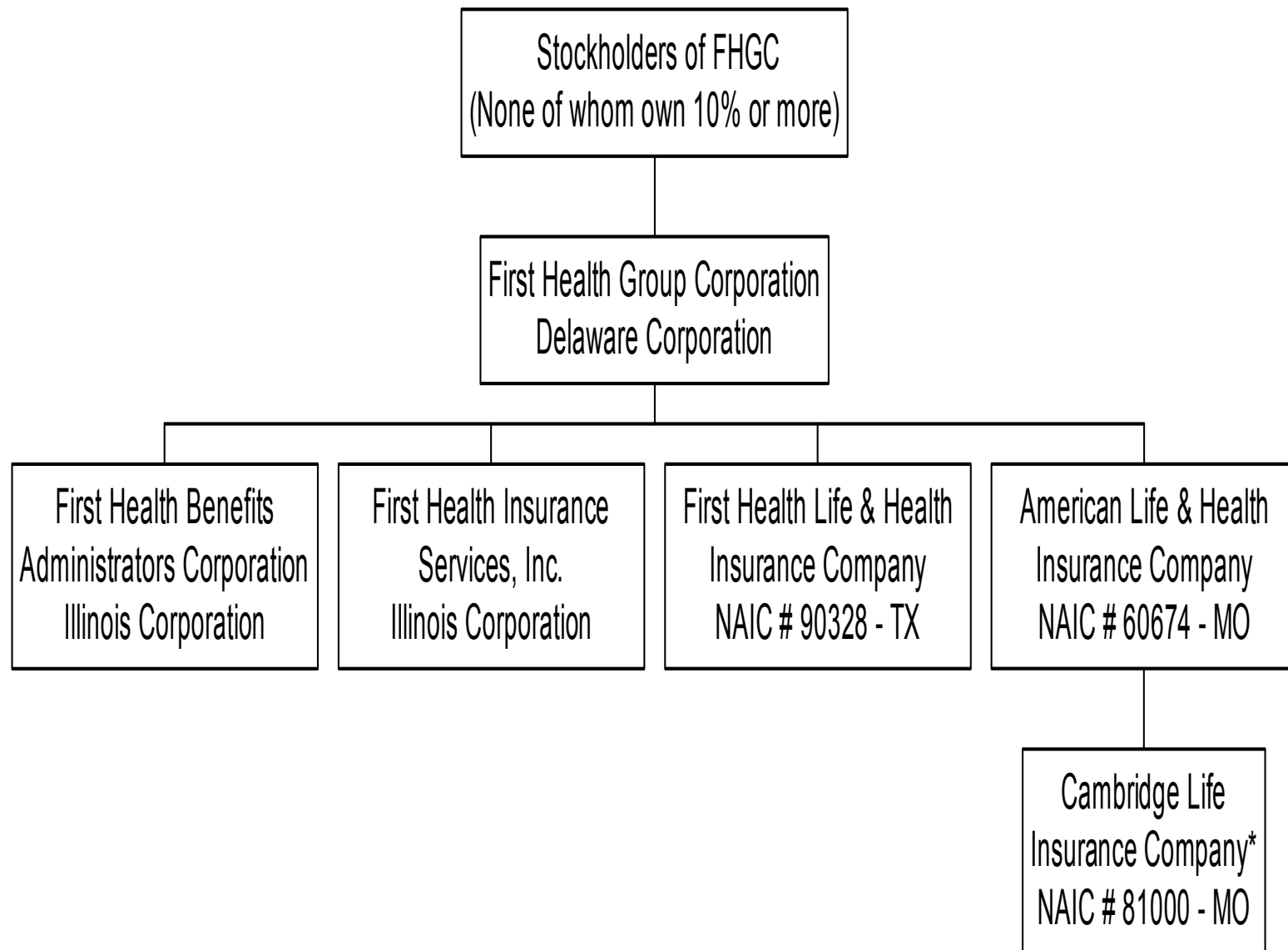
Corporation (FHSC), a Virginia corporation. In 2003, Cambridge Life became a direct subsidiary of First Health Group Corporation (FHGC) through a dividend of the capital stock of Cambridge Life from FHSC to FHGC. American L&H is a wholly owned subsidiary of First Health Group Corporation, a Delaware corporation. First Health Group Corporation is an independent provider of medical cost management services including a national Preferred Provider Organization, various medical review programs and computer assisted repricing services.

FHGC is a publicly-held company traded on the NASDAQ National Market under the symbol FHCC. As of December 31, 2001, there were 100,022,000 shares of FHGC common stock outstanding. No individual shareholder, directly or beneficially, owned 10% or more of the outstanding shares.

Insurance Holding Company System Registration Statements have been filed annually by American L&H with the State of Missouri on behalf of itself and Cambridge Life during the examination period.

Organizational Chart

The following organizational chart partially depicts the holding company system of American L&H as of December 31, 2001. The only non-insurance company subsidiaries of First Health Group Corporation included in the chart are those who have intercompany agreements with American L&H.



*Subsequent to the examination date, Cambridge Life was sold to First Health Services Corporation (FHSC). In 2003, Cambridge Life became a direct subsidiary of FHGC when the stock of Cambridge Life was transferred to FHGC as a dividend from FHSC.

Intercompany Transactions

American L&H has entered into various intercompany agreements including:

1. Type: Administrative Agreement

 Parties: American L&H and Cambridge Life

 Effective: June 1993. Amended January 1998.

 Terms: American L&H administers accident and health policies of Cambridge Life for a fee based on a percentage (11.57%) of the gross premium collected for Cambridge Life. American L&H performs all claims, underwriting, billing, and actuarial data services in connection with this business.

2. Type: Cost Sharing Agreement

 Parties: American L&H and Cambridge Life

 Effective: January 1993. Amended February 1997, January 1998, and January 2000.

 Terms: American L&H provides office space, computer equipment, office equipment and office supplies for fixed monthly fees. American L&H also provides executive personnel in exchange for the reimbursement of a percentage of executive compensation based on time spent by the executives on Cambridge Life.

3. Type: Administrative Services Agreement

 Parties: First Health Benefits Administrators Corp. (FHBAC, previously HealthCare COMPARE Administrative Services, Inc. (HCCAS)) and American L&H

 Effective: September 1998. (Replaces October 1996 agreement.)

 Terms: FHBAC serves as a Third-Party Administrator (TPA) for American L&H, administering primarily stop loss policies. Fees paid to FHBAC under this agreement are 3% of the premium on policies administered. This agreement is currently inactive as these types of policies are not currently being written by American L&H.

4. Type: Agent Agreement
- Parties: First Health Insurance Services, Inc. (FHISI) and American L&H
- Effective: September 1998. (Replaces Jan. 1996 Commission Agreement.)
- Terms: First Health Insurance Services, Inc. serves as an agent of American L&H, marketing group health and stop loss policies for a commission of up to 20%. This agreement is currently inactive as these types of policies are not currently being written by American L&H.
5. Type: Client Contract
- Parties: First Health Group Corp. and American L&H
- Effective: November 1995. Amended and restated January 1996. Amended September 1998.
- Terms: First Health Group Corp. provides American L&H with access to managed care services for American L&H to offer with its managed care insurance products. Usage-based fees are charged for the managed pharmacy system services, passed-through at the rate charged by the Pharmacy Administrator. No separate fees are due under this agreement for medical cost management services as reimbursement for these services is contained in the reimbursement American L&H pays under the Agreement for Administrative and Financial Services and Overhead Allocation discussed below.
6. Type: Agreement for Administrative and Financial Services and Overhead Allocation
- Parties: First Health Group Corp. and American L&H
- Effective: September 1998. (Replaces October 1996 agreement.)
- Terms: First Health Group Corp. provides employees for American L&H's operations. American L&H reimburses FHGC for an amount equal to these employees' gross compensation and related employee benefits. FHGC also provides medical cost management, legal, administrative and financial services to American L&H for a monthly fee of \$10,000. The contract allows for this fee to be waived annually by FHGC if the pre-tax income of American L&H, prior to the \$120,000 annual fee, is less than \$240,000. The \$120,000 annual fee was waived for 1999.

The following is a table of amounts incurred (or received) under the above described American L&H intercompany agreements. This table shows the other party to the agreement, the agreement name, and the dollar amount incurred (or received) by American L&H under each agreement for 1999, 2000, and 2001.

	2001	2000	1999
Cambridge Life Insurance Company:			
Administrative Agreement	\$(10,032)	\$(10,967)	\$(11,719)
Cost Sharing Agreement	(44,220)	(52,805)	(117,480)
First Health Benefits Administrators Corp.:			
Administrative Services Agreement	0	6,810	10,374
First Health Insurance Services, Inc.:			
Agent Agreement	0	22,699	38,868
First Health Group Corp.:			
Client Contract ¹	0	0	0
Admin, Fincl Serv & O/H Allocation:			
Payroll and Benefit Reimbursement	637,006	694,049	905,563
Annual Fee ²	120,000	120,000	0
TOTALS	<u>\$702,754</u>	<u>\$779,786</u>	<u>\$825,606</u>

American L&H also ceded individual life business to Cambridge Life under a quota share reinsurance contract effective July 1, 1993. In 2002, American L&H and Cambridge Life entered into an assumption reinsurance agreement whereby Cambridge Life assumes health business from American L&H. These agreements are discussed under the Reinsurance section of this examination report.

¹ The only fees paid under this agreement are those fees charged by the Pharmacy Administrator to FHGC and passed through to American L&H based on the actual amount paid by FHGC.

² The \$120,000 annual fee to FHGC was waived for 1999.

FIDELITY BOND AND OTHER INSURANCE

The Company is a named insured, along with two of its affiliates, on a financial institutions bond providing coverage with a \$300,000 limit. The NAIC suggested minimum coverage for the covered companies was \$400,000 as of December 31, 2001, and \$500,000 as of December 31, 2002. It is recommended the Company increase its bond to at least the suggested minimum recommended by the NAIC.

American L&H is a named insured on the following insurance policies with its ultimate parent, First Health Group Corporation and affiliates:

General Liability	Property
Workers' Compensation	Errors and Omissions
Employment Practices Liability	Directors and Officers Liability
Commercial Automobile	Umbrella

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

American L&H does not have any employees. All personnel are employed by an affiliate, FHGC. A variety of standard benefits are provided to employees including medical, dental, group life, accidental death and dismemberment coverage, 401k plan, tuition reimbursement and a stock option plan. The Company does not have a direct obligation for these benefits. It appears that the Company has properly reported any related liability in its intercompany account.

STATUTORY DEPOSITS

Deposits with the State of Missouri

The funds on deposit with the Missouri Department of Insurance as of December 31, 2001, as reflected below, were sufficient to meet the capital deposit requirements for the State of Missouri in accordance with Section 376.290 RSMo (Trust Deposits). The

Company's required deposit for Missouri is \$600,000. The funds on deposit as of December 31, 2001, were as follows:

Type of Security	Par Value	Market Value	Statement Value
U.S. T-Note	\$ 150,000	\$ 156,938	\$ 150,489
U.S. T-Note	150,000	160,547	150,037
U.S. T-Bond	450,000	452,813	459,015
FNMA Note	350,000	413,109	373,436
	<u>\$ 1,100,000</u>	<u>\$ 1,183,407</u>	<u>\$ 1,132,977</u>

Deposits with Other States

The Company does not have funds on deposit with any other state.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operations

The Company is licensed with the Missouri Department of Insurance under RSMo Chapter 376 for life, annuities and endowments and accident and health insurance. American L&H is licensed to transact the business of insurance in the following four states: California, Illinois, Missouri, and Wisconsin.

During the examination period, the vast majority of American L&H's premium income was accident and health (A&H). A&H premium varied from a low of \$4.8 million in 2000 to a high of \$7.7 million in 2002. In contrast, the life premium was due to renewals on ordinary life insurance and fell from a high of \$177,355 in 1999 to a low of \$116,669 in 2002. The majority of the A&H business in all years was in California. The majority of the California A&H was Medicare Supplement business. The second

highest source of A&H premium was the Missouri Consolidated Health Care Plan (MCHCP) health insurance which American L&H began writing in January 2000. This MCHCP business was assumed by American L&H's affiliate, Cambridge Life Insurance Company, effective October 2002. American L&H also wrote some small group medical and dental insurance programs, primarily distributed through Third Party Administrator relationships.

American Life & Health Insurance Company's parent, First Health Group Corporation, plans to sell American L&H. American L&H is divesting itself of all non-life business in preparation for this sale. As noted above, the MCHCP health business has been assumed by Cambridge Life. American L&H is currently in discussions with a non-affiliate to transfer the Medicare Supplement business.

Policy Forms & Underwriting

Advertising & Sales Material

Treatment of Policyholders

The Missouri Department of Insurance (MDI) has a market conduct staff, which performs a review of these issues and generates a separate market conduct report. However, the MDI has not performed a market conduct examination of the Company. A market conduct examination was conducted by the California Department of Insurance and the July 31, 2002 report of this examination was reviewed with no significant items noted.

A cursory review was made of several market conduct related areas of the Company during the examination. No problems were noted.

REINSURANCE

General

The Company's reinsurance and premium activity for the three-year period ending December 31, 2001, is detailed below:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Direct Premiums	\$7,079,634	\$4,986,181	\$5,428,586
Assumed Premiums:			
Affiliates	0	0	0
Non-affiliates	1,077,807	1,161,783	1,523,266
Ceded Premiums:			
Affiliates	13,194	13,641	16,591
Non-affiliates	<u>2,803,747</u>	<u>2,254,945</u>	<u>2,003,213</u>
Net Premiums Written	<u>\$5,340,500</u>	<u>\$3,879,378</u>	<u>\$4,932,048</u>

Assumed

American L&H entered into a quota-share agreement with BEST Life Assurance Company of California (BEST Life) on October 1, 1991, to assume 90% of a few specific accident and health plans offered by BEST Life. This agreement was amended on March 1, 1993, to include a 50% assumption of certain short-term accident and health business. On January 1, 1998, American L&H entered into a second quota-share agreement to assume 85% of specific medical, prescription drugs, group term life, and accidental death and dismemberment plans presented under Beneficial Employees Security Trust of Utah and California offered by BEST Life. The majority of the business assumed by American L&H during 2001 was under the January 1, 1998 agreement with BEST Life.

Ceded

On July 1, 1993, the Company entered into an agreement with its affiliate, Cambridge Life Insurance Company (Cambridge Life), wherein American L&H cedes

10% of its ordinary life business. Subsequent to the exam period, on October 1, 2002, the Company entered into an Assumption Reinsurance Agreement with Cambridge Life, wherein the Company affected a complete novation from American L&H to Cambridge Life in respect to every health and disability insurance policy, and rider, relating to policyholders or contract-holders residing in the state of Missouri, so that American L&H has no further obligations related to these policies or contracts.

An excess of loss agreement covering medical and dental benefits was executed with AIG Life Insurance Company (AIG) effective May 1, 1996 and renewed annually through April 30, 2003. This agreement was not renewed May 1, 2003. The specific retention amount per covered person per policy year was \$125,000 with a yearly aggregate limit of \$875,000. The yearly agreement does not contain an insolvency clause until an amendment is added after the end of the policy year. Since it occurs after the end of the policy-year, this post-contract amendment adding the insolvency clause is unacceptable and does not meet the requirements of Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance). The lack of an acceptable insolvency clause for this contract was also noted in the prior examination. The Company is directed to ensure that reinsurance credits are not taken for any reinsurance agreement that does not fully comply with all the provisions of Missouri Regulation 20 CSR 200-2 (Credit for Reinsurance).

American L&H entered into a quota share agreement with National Healthcare Reinsurance Company whereby the Company cedes 90% of certain Medicare supplement policies effective July 1, 1994. This agreement accounted for over eighty percent (80%) of premium ceded during the examination period.

Effective April 1, 1994, the Company entered into a quota-share reinsurance agreement with American Labor Life Insurance Company. Under this agreement, American L&H cedes 50% of all policies of life, accident and health insurance written after April 1, 1994, through its third party administrator, Tower Insurance Services, Incorporated.

On July 1, 1992, the Company entered into a quota-share reinsurance agreement with Life and Health Insurance of America to cede 50% of life, accident and health, and Medicare supplement insurance policies written by agents of Tower Insurance Services, Incorporated, a third party administrator.

American L&H has several other treaties that have been terminated and are now in run-off. These treaties currently involve minimal premium and activity.

The Company is contingently liable for all reinsurance losses ceded to others. This contingent liability would become an actual liability in the event that an assuming reinsurer should fail to perform its obligations under its reinsurance agreement with the Company.

ACCOUNTS AND RECORDS

Financial statements of the Company were audited by the CPA firm, Deloitte & Touche LLP, Costa Mesa, California, for the years ending December 31, 2001, 2000, and 1999.

Loss reserves of the Company were reviewed and certified by Jon Paul Dorris, FSA, MAAA, of West Coast Actuarial and Financial Consultants, Inc. for the years ending December 31, 2001, 2000, and 1999.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Company for the period ending December 31, 2001. Any examination adjustments to the amount reported in the Annual Statement and/or comments regarding such are made in the “Notes to the Financial Statements”. (The failure of any column of numbers to add to its respective total is due to rounding or truncation.)

There may have been differences found in the course of this examination, which are not shown in the “Notes to the Financial Statements”. These differences were determined to be immaterial, concerning their effect on the financial statements. Therefore they were communicated to the Company and/or noted in the workpapers for each individual Annual Statement item.

Analysis of Assets

	<u>ASSETS</u>	<u>NON- ADMITTED ASSETS</u>	<u>NET ADMITTED ASSETS</u>
Bonds	\$10,739,984		\$10,739,984
Stocks:			
Preferred stocks	1,205,804		1,205,804
Common stocks	3,519,391		3,519,391
Policy loans	101,870		101,870
Cash and short-term investments	5,882,510		5,882,510
Reinsurance ceded:			
Amounts recoverable from reinsurers	465,862		465,862
Commissions and expense allowances due	26,080		26,080
Federal income tax recoverable	23,870		23,870
Life insurance premiums deferred and uncollected	39,688		39,688
Accident and health premiums due and unpaid	303,093		303,093
Investment income due and accrued	170,089		170,089
Receivable from parent, subsidiary and affiliates	2,754		2,754
Other assets nonadmitted	2,273	2,273	0
Aggregate write-ins for other than invested assets:			
Funds held for ceding company	50,000		50,000
Funds on deposit-unauthorized reinsurers	542,841		542,841
Miscellaneous write-ins	1,604		1,604
Total assets	<u><u>\$23,077,713</u></u>	<u><u>\$2,273</u></u>	<u><u>\$23,075,440</u></u>

Liabilities, Surplus and Other Funds

Aggregate reserve for life policies and contracts	\$ 3,271,327
Aggregate reserve for accident and health policies	106,758
Liability for deposit-type contracts	25,241
Policy and contract claims:	
Life	40,700
Accident and health	1,172,898
Policyholders' dividends and coupons due and unpaid	300
Provision for policyholders' dividends not yet apportioned	250
Premium and annuity considerations received in advance	15,476
Surrender value on canceled policies	(130)
Interest maintenance reserve	(49,372)
Commissions to agents due or accrued	41,231
Commissions and expense allowances payable on reinsurance assumed	8,438
General expenses due or accrued	184,315
Taxes, licenses and fees due or accrued, excluding fed'l income taxes	171,237
Unearned investment income	28
Amounts withheld or retained by company as agent or trustee	169,619
Asset valuation reserve	77,234
Reinsurance in unauthorized companies	170,353
Funds held under reinsurance treaties with unauthorized reinsurers	542,841
Payable to parent, subsidiaries and affiliates	181,861
Aggregate write-ins for liabilities:	
Funds held for sale of Cambridge Life stock	3,600,212
Total liabilities	9,730,817
Common capital stock	2,500,755
Surplus notes	-
Gross paid in and contributed surplus	7,312,370
Unassigned funds (surplus)	3,531,497
Surplus as regards policyholders	13,344,622
Total liabilities and surplus	\$ 23,075,439

Statement of Income

Premium and annuity considerations for life and A&H policies	\$5,435,304
Net investment income	836,841
Amortization of interest maintenance reserve	3,881
Commissions and expense allowances on reinsurance ceded	299,315
Miscellaneous income	37,042
Total	<u>6,612,383</u>
Death benefits	200,838
Disability benefits and benefits under accident and health policies	3,618,478
Coupons, guaranteed annual pure endowments and similar benefits	23,531
Surrender benefits and withdrawals for life contracts	70,784
Payments on supplemental contracts with life contingencies	1,538
Increase in aggregate reserves for life and A&H policies and contracts	<u>(160,949)</u>
Total	3,754,220
Commissions on premiums and annuity considerations	412,046
Commissions and expense allowances on reinsurance assumed	167,390
General insurance expenses	1,172,406
Insurance taxes, licenses and fees, excluding federal income taxes	214,644
Increase in loading on deferred and uncollected premiums	<u>(12,134)</u>
Total	<u>5,708,572</u>
Net gain from operations before dividends to policyholders	903,811
Dividends to policyholders	<u>258</u>
Net gain from operations before federal income taxes	903,553
Federal income taxes incurred	<u>1,000</u>
Net gain from operations after federal income taxes	902,553
Net realized capital gains or (losses) less capital gains tax	<u>(19,133)</u>
Net Income	<u><u>\$ 883,420</u></u>

Capital and Surplus Account

Capital and surplus, December 31, 2000	\$ 12,048,491
Net income	883,420
Change in net unrealized capital gains/losses	(45,317)
Change in net deferred income tax	10,951
Change in non-admitted assets and related items	381
Change in liability for reinsurance in unauthorized companies	(37,043)
Change in asset valuation reserve	(38,232)
Change in surplus notes	(7,635,759)
Cumulative effect of changes in accounting principles	12,919
Capital changes:	
Paid in	7,062,370
Aggregate write-ins for gains and losses in surplus:	
Equity of CHP	808,552
Interest on surplus note - CHP	274,389
Tax provision - previous year	(500)
Capital and surplus, December 31, 2001	<u>\$ 13,344,622</u>

NOTES TO THE FINANCIAL STATEMENTS

NONE

EXAMINATION CHANGES

NONE

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Fidelity Bond and Other Insurance (Page 16)

The Company is a named insured, along with two of its affiliates, on a financial institutions bond providing coverage with a \$300,000 limit. The NAIC suggested minimum coverage for the covered companies was \$400,000 as of December 31, 2001, and \$500,000 as of December 31, 2002. It is recommended the Company increase its bond to at least the suggested minimum recommended by the NAIC.

Reinsurance Ceded (Page 20)

During the examination period, the Company obtained yearly amendments to its Excess of Loss Agreement with AIG Life Insurance Company, adding an insolvency clause after the end of the policy year. Since it occurs after the end of the policy year, this post-contract amendment is unacceptable and does not meet the requirements of Missouri Regulation 20 CSR 200-2.100(11)(A) (Credit for Reinsurance). The Company is directed to ensure that reinsurance credits are not taken for any reinsurance agreement that does not fully comply with all the provisions of Missouri Regulation 20 CSR 200-2 (Credit for Reinsurance).

SUBSEQUENT EVENTS

In 2002, American Life and Health Insurance Company sold Cambridge Life Insurance Company to another affiliate, First Health Services Corporation (FHSC), a Virginia corporation. In 2003, Cambridge Life became a direct subsidiary of FHGC through a dividend of the capital stock of Cambridge Life from FHSC to FHGC.

October 1, 2002, American L&H and Cambridge Life entered into an assumption reinsurance agreement whereby Cambridge Life assumes Missouri Consolidated Health Care Plan (MCHCP) health business from American L&H. These agreements are discussed under the Reinsurance section of this examination report.

American L&H is currently in discussions with a non-affiliate to transfer the Medicare Supplement business.

FHGC is currently in negotiations with Security National Life Insurance Company (a Utah–domiciled life insurance company) for the sale of American L&H. As of May 22, 2003, no contract had been finalized and regulatory approvals had not been granted.

ACKNOWLEDGMENT

The assistance and cooperation extended by the officers and the employees of American Life and Health Insurance Company during the course of this examination is hereby acknowledged and appreciated. In addition to the undersigned, Angela Campbell, AFE, an examiner for the Missouri Department of Insurance, participated in this examination.

VERIFICATION

State of Missouri)
)
County of)

I, Vicki L. Denton, CFE, on my oath swear that to the best of my knowledge and belief the above examination report is true and accurate and is comprised of only facts appearing upon the books, records or other documents of the Company, its agents or other persons examined or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

Vicki L. Denton, CFE
Examiner-In-Charge
Missouri Department of Insurance

Sworn to and subscribed before me this _____ day of _____, 2003.

My commission expires: _____

Notary Public

SUPERVISION

The examination process has been monitored and supervised by the undersigned. The examination report and supporting workpapers have been reviewed and approved. Compliance with NAIC procedures and guidelines as contained in the Financial Condition Examiners Handbook has been confirmed.

Frederick G. Heese, CFE, CPA
Audit Manager
Missouri Department of Insurance